

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: August 29, 2022
To: Board of Governors
From: Staff¹
Subject: Proposed Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts

ACTIONS REQUESTED: Approval of the attached draft proposed *Policy Statement on Prudent Commercial Real Estate (CRE) Loan Accommodations² and Workouts³*, which would update and revise existing guidance on CRE loan workouts issued in 2009.⁴ Staff also requests authority to make technical, non-substantive changes to the attached materials prior to publication in the Federal Register.

EXECUTIVE SUMMARY:

- The proposed statement is identical to the proposal issued by the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the National Credit Union Administration on August 2, 2022, and was developed jointly with those agencies.
- The proposed statement would reinforce the 2009 statement’s message that financial institutions should work prudently and constructively with creditworthy borrowers experiencing financial difficulties, clarify that such message applies in all economic cycles, and add a new section on short-term loan accommodations.

¹ Michael Gibson, Anna Lee Hewko, Juan Climent, Katie Ballintine, Carmen Holly, and Ryan Engler, Division of Supervision and Regulation; Mark Van Der Weide, Charles Gray, Jay Schwarz, and Gillian Burgess, Legal Division.

² An accommodation includes any agreement to defer one or more payments, make a partial payment, forbear any delinquent amounts, modify a loan or contract, or provide other assistance or relief to a borrower who is experiencing a financial challenge.

³ Workouts can take many forms, including a renewal or extension of loan terms, extension of additional credit, or a restructuring with or without concessions.

⁴ The 2009 statement was drafted jointly by the Board, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC) (collectively, the agencies), the Federal Financial Institutions Examination Council (FFIEC) State Liaison Committee, and the former Office of Thrift Supervision and issued by the FFIEC. See [SR 09-7](#), “*Policy Statement on Prudent Commercial Real Estate Loan Workouts*.”

- The proposed statement would address recent accounting changes on estimating loan losses and provide updated examples that clarify how to classify and account for loans modified or affected by loan accommodations or loan workout activity.
- The proposed statement is timely in the post-pandemic era, as COVID-related guidance⁵ sunsets and trends such as increased remote working may shift historic patterns of demand for commercial real estate in ways that adversely affect the financial condition and repayment capacity of CRE borrowers.

DISCUSSION:

A. Background

The 2009 statement was designed to encourage financial institutions to work with CRE borrowers during times of financial stress, as prudent CRE loan workout arrangements are often in the best interest of both the financial institution and the borrower. The 2009 statement affirmed that examiners would not criticize prudent loan workout arrangements and would not automatically adversely classify renewed or restructured loans when the value of the collateral fell below the loan balance. The 2009 statement also aimed to promote supervisory consistency among examiners and to ensure that supervisory policies and actions would not inadvertently curtail the availability of credit to sound borrowers.

The proposed statement would update and expand the 2009 statement to affirm that the “work with your borrowers” message is applicable in all economic cycles; incorporate recent policy guidance on loan accommodations developed in response to the COVID event⁶; discuss recent accounting developments in estimating loan losses; and revise the existing appendix of workout scenarios for various CRE property types. In developing the proposed

⁵ See [Joint Press Release April 7, 2020](#), “*Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)*”; See also [SR 20-18](#), “*Joint Statement on Additional Loan Accommodations Related to COVID-19*.”

⁶ See [SR 20-18](#).

statement, the Board and other agencies consulted with the Federal Financial Institutions Examination Council (FFIEC) State Liaison Committee.

The proposed statement is timely in the post-pandemic era, as it may be helpful to reiterate the message that financial institutions should work with their borrowers on CRE loan accommodations and workouts before the existing COVID-related guidance sunsets.⁷ Trends such as increased remote working may shift historic patterns of demand for commercial real estate, and the sector faces additional risks (e.g., supply chain imbalances, labor challenges, and vulnerability to rising interest rates) that could adversely affect the financial condition and repayment capacity of CRE borrowers.

B. Proposed Statement

The proposed statement would build on and supersede the 2009 statement, reiterating the need for financial institutions to work prudently and constructively with creditworthy borrowers who are experiencing financial difficulty. While borrowers may experience deterioration in their financial condition, many continue to be creditworthy and have the willingness and capacity to repay their debts. The proposed statement would clarify and affirm, before the existing COVID-related guidance sunsets, that financial institutions should work with their borrowers on loan accommodations and workouts through all economic cycles and will not be criticized for initiating workout activities or if the value of the collateral falls below the loan balance. The proposed statement would also address supervisory expectations with respect to a financial institution's handling of loan

⁷ See [Joint Press Release April 7, 2020](#); See also [SR 20-18](#).

accommodations and workouts on matters including: (1) risk management elements (e.g., prudent underwriting standards and internal controls); (2) classification of loans as special mention or adverse (e.g., substandard, doubtful, or loss); (3) regulatory reporting; and (4) accounting considerations.

The proposed statement would include a new section on short-term loan accommodations, a tool available to financial institutions prior to moving borrowers into long-term workout arrangements. These short-term, less-complex accommodations may help mitigate long-term adverse effects on borrowers by allowing them to address the issues affecting their repayment capacity. The section on short-term accommodations would incorporate principles consistent with existing interagency guidance.⁸

The proposed statement would reflect recent accounting changes, including those related to the Current Expected Credit Losses methodology⁹ and the Financial Accounting Standards Board decision to eliminate troubled debt restructurings (TDRs) as a reportable field in 2023. Board staff proposes retaining some discussion of TDRs in the proposed statement and would plan to remove all TDR references by year-end 2023.¹⁰ The proposed statement would also update and expand the 2009 statement's extensive appendix of examples detailing workout scenarios for various CRE property types. The examples would

⁸ See [SR 20-18](#).

⁹ Appendices 5 and 6 of the proposed statement would address the relevant accounting and regulatory guidance on estimating loan losses for financial institutions that use the CECL methodology, or incurred loss methodology, respectively.

¹⁰ TDR reporting is being phased out and will no longer be required for CECL adopters starting in of 2023. Board staff proposes retaining TDR references in the proposed statement until all financial institutions adopt CECL in 2023.

discuss how to classify and account for loans modified or affected by loan accommodations or loan workout activity.

RECOMMENDATIONS:

Staff recommends that the Board approve the attached draft proposed policy statement for public comment. Staff also recommends that the Board authorize staff to make technical, non-substantive changes to the attached materials prior to publication.